

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type <input checked="" type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name CITY OF HARRISVILLE WATER & SEWER FUNDS	County ALCONA
Audit Date 12/31/2004	Opinion Date 02/04/2005	Date Accountant Report Submitted to State: 03/28/2005	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.


We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ yes ☒ no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ yes ☒ no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ yes ☒ no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ yes ☒ no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ yes ☒ no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ yes ☒ no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ yes ☒ no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ yes ☒ no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ yes ☒ no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) STEPHENSON, GRACIK & CO., P.C.			
Street Address 325 NEWMAN STREET, PO BOX 592	City EAST TAWAS	State MI	ZIP 48730
Accountant Signature  Signature Valid		Digitally signed by Stephenson, Grack and Co., P.C. DN: cn=Stephenson, Grack and Co., P.C., c=US Date: 2005.02.14 14:30:02 -05'00'	



Stephenson Gracik & Co., P.C.

Certified Public Accountants & Consultants

Alan J Stephenson, CPA
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Herman A Bertuleit, CPA

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
ALCONA COUNTY, MICHIGAN

AUDITORS' REPORT
YEAR ENDED DECEMBER 31, 2004

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AUDITORS' REPORT

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February 4, 2005

Independent Auditors' Report

Members of the City Council
City of Harrisville
Alcona County, Michigan

We have audited the accompanying financial statements of the business-type activities of the Water and Sewer Funds of the City of Harrisville, Alcona County, Michigan, as of and for the year ended December 31, 2004, which collectively comprise the City of Harrisville Water and Sewer Funds' basic financial statements, as listed in the index. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the City of Harrisville Water and Sewer Funds and do not purport to, and do not present fairly the financial position of the City of Harrisville, Alcona County, Michigan, as of December 31, 2004, and the changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

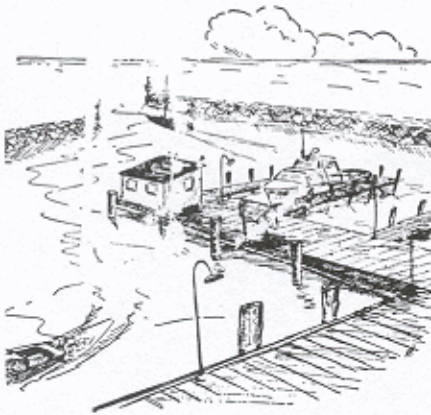
In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the business-type activities of the City of Harrisville Water and Sewer Funds, Alcona County, Michigan, as of December 31, 2004, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 4, 2005, on our consideration of the City of Harrisville Water and Sewer Funds' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

As described in Note 2, the City of Harrisville Water and Sewer Funds have implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements -and Management's Discussion and Analysis-for State and Local Governments*, as of December 31, 2004.

The management's discussion and analysis information is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Stephenson, Gracik & Co., P.C.



Harbor of Refuge - Dedicated August 6, 1961

City of Harrisville

Office of the Mayor

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the **Water and Sewer Funds of the City of Harrisville** (the Water and Sewer Funds), we offer readers of the Water and Sewer Funds' financial statements this narrative overview and analysis of the financial activities of the Water and Sewer Funds for the fiscal year ended December 31, 2004. This Analysis, a requirement of Governmental Accounting Standards Board Statement 34 (GASB 34), omits certain comparative data that will be available in future years.

Financial Highlights

- The Water and Sewer Funds' assets exceeded its liabilities by \$1,236,305 (*net assets*) for the fiscal year reported. Of this amount, \$509,708 (*unrestricted net assets*) represents the portion available for spending.
- The Water and Sewer Funds' total net assets increased by \$36,983 or 3.1% over the course of the year's operations.

Overview of the Financial Statements

This annual report includes this management's discussion and analysis report, the independent auditors' report and the basic financial statements of the Water and Sewer Funds. The basic financial statements include notes that explain, in more detail, some of the information in the financial statements.

Required Financial Statements

The financial statements of the Water and Sewer Funds report information using accounting methods similar to those used by private sector companies. These statements offer short- and long-term financial information about its activities. The Statement of Net Assets includes all of the Water and Sewer Funds' assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to Authority creditors (liabilities). The Statement of Net Assets also provides the basis for evaluating the capital structure and assessing the liquidity and financial flexibility of these funds.

All of the current year's revenues and expenses are accounted for in the Statement of Revenue, Expenses and Changes in Net Assets. This statement measures the success of the Water and Sewer Funds' operations over the past year and can be used to determine whether the Water and Sewer Funds have successfully recovered all its costs through its user fees and other charges, profitability and credit worthiness.

The final required financial statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, financing and investing activities. It provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Notes to Financial Statements

The accompanying notes to financial statements provide information essential to a full understanding of the financial statements. The notes to financial statements begin on page 9 of this report.

Analysis of Financial Position:

One of the most important questions asked about the Water and Sewer Funds' finances is "Are the Water and Sewer Funds as a whole better off or worse off as a result of this year's activities?" The Statement of Net Assets and the Statement of Revenue, Expenses, and Changes in Net Assets report information about the Water and Sewer Funds' activities in a way that will help answer this question. These two statements report the net assets of the Water and Sewer Funds and the changes in them. One can think of the Water and Sewer Funds' net assets (the difference between assets and liabilities) as one way to measure financial health or financial position. Over time, increases or decreases in the Water and Sewer Funds' net assets are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions and new or changed government legislation.

Because this is the first year of implementation of Government Accounting Standards Board Statement No. 34, which requires this new reporting model, the following tables present only current year data. In future years, when prior-year information is available, comparative analysis will be presented.

Summary of Net Assets:

The following summarizes the net assets of the Water and Sewer Funds of the City of Harrisville at December 31, 2004:

Net Assets Summary

	<u>Water Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
Current Assets	\$ 391,325	\$ 132,661	\$ 523,986
Capital Assets - net	<u>960,705</u>	<u>490,892</u>	<u>1,451,597</u>
Total Assets	<u>1,352,030</u>	<u>623,553</u>	<u>1,975,583</u>
Current Liabilities	20,195	23,083	43,278
Long-Term Liabilities	<u>501,000</u>	<u>195,000</u>	<u>696,000</u>
Total Liabilities	<u>521,195</u>	<u>218,083</u>	<u>739,278</u>
Net Assets			
Investment in Capital Assets	448,705	277,892	726,597
Unrestricted	<u>382,130</u>	<u>127,578</u>	<u>509,708</u>
Total Net Assets	<u>\$ 830,835</u>	<u>\$ 405,470</u>	<u>\$ 1,236,305</u>

Capital Asset and Debt Administration

Capital Assets

The Water and Sewer Funds' investment in capital assets as of December 31, 2004, amounted to \$1,451,597 (net of accumulated depreciation). This investment in capital assets includes land, distribution and collection systems, and machinery and equipment. Capital assets for the Water and Sewer Funds decreased by \$67,421 as a result of current year depreciation. Accumulated depreciation as of December 31, 2004 was \$1,342,376.

Capital Assets Summary (Net of depreciation)

Land	\$ 18,000
Distribution and collection systems	2,716,812
Machinery and equipment	<u>59,161</u>
Subtotal	2,793,973
Less accumulated depreciation	<u>1,342,376</u>
Capital Assets - Net	<u>\$ 1,451,597</u>

Additional information on capital assets can be found in Exhibit D – page 10.

Long-Term Debt

At year end, long-term debt (due in more than one year) amounted to \$696,000. Such debt includes *Bonds and Contracts Payable*.

Summary of Revenues and Expenses:

The following summarizes the revenues and expenses of the Water and Sewer Funds of the City of Harrisville at December 31, 2004:

	<u>Water Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
Operating revenue	\$ 77,133	\$ 86,507	\$ 163,640
Non operating revenue	<u>46,628</u>	<u>785</u>	<u>47,413</u>
Total revenues	<u>123,761</u>	<u>87,292</u>	<u>211,053</u>
Depreciation expense	33,522	33,899	67,421
Other operating expense	38,934	30,365	69,299
Nonoperating expense	<u>25,850</u>	<u>11,500</u>	<u>37,350</u>
Total expenses	<u>98,306</u>	<u>75,764</u>	<u>174,070</u>
Change in Net Assets	<u>\$ 25,455</u>	<u>\$ 11,528</u>	<u>\$ 36,983</u>

Economic Factors and Next Year's Budget and Rates

The management of the Water and Sewer Funds considered many factors in setting the fiscal year 2005 budget, user fees and charges. As always, the overriding factor was to keep expenses at or below the amount of revenue. The majority of revenue generated by the Water and Sewer Funds are derived from charges for water and sewer services. Water and sewer rates did not change during fiscal year 2004 and are not expected to change in 2005.

The most significant expenses remain employee related costs, operating supplies and system repairs and depreciation .

Requests for Information

This financial report is designed to provide a general overview of the Water and Sewer Funds of the City of Harrisville for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City Mayor, P.O. Box 278, Harrisville, Michigan 48740.

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
December 31, 2004

	Business-Type Activities Enterprise Funds		
	Water Fund	Sewer Fund	Total
<u>Assets</u>			
Current assets:			
Cash and cash equivalents (Note 3)	\$ 214,003	\$ 81,680	\$ 295,683
Investments (Note 3)	159,076	30,000	189,076
Accounts receivable	17,163	20,981	38,144
Due from other funds	1,083	0	1,083
Total current assets	391,325	132,661	523,986
Noncurrent assets:			
Capital assets, net (Note 4)	960,705	490,892	1,451,597
Total Assets	1,352,030	623,553	1,975,583
<u>Liabilities</u>			
Current liabilities:			
Due to other funds	0	5,083	5,083
Deferred revenue	9,195	0	9,195
Bond payable (Note 5)	11,000	0	11,000
Contract payable (Note 5)	0	18,000	18,000
Total current liabilities	20,195	23,083	43,278
Long-term liabilities:			
Bond payable (Note 5)	501,000	0	501,000
Contract payable (Note 5)	0	195,000	195,000
Total noncurrent liabilities	501,000	195,000	696,000
Total Liabilities	521,195	218,083	739,278
<u>Net Assets</u>			
Investment in capital assets, net of related debt	448,705	277,892	726,597
Unrestricted	382,130	127,578	509,708
Total Net Assets	\$ 830,835	\$ 405,470	\$ 1,236,305

The accompanying notes to the financial statements are an integral part of this statement.

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET ASSETS
PROPRIETARY FUNDS
For the Year Ended December 31, 2004

	Business-Type Activities Enterprise Funds		
	Water Fund	Sewer Fund	Total
<u>Operating Revenue</u>			
Charges for services	\$ 74,691	\$ 84,308	\$ 158,999
Permits	900	800	1,700
Service connection charges	1,462	1,334	2,796
Refunds	80	65	145
Total operating revenue	<u>77,133</u>	<u>86,507</u>	<u>163,640</u>
<u>Operating Expenses</u>			
Salaries and wages	12,774	12,796	25,570
Employee benefits	5,130	5,108	10,238
Office supplies	434	520	954
Operating supplies	3,637	972	4,609
Telephone	1,092	820	1,912
Insurance	2,094	642	2,736
Utilities	1,920	3,002	4,922
Repairs	5,424	1,676	7,100
Equipment rentals	2,674	2,469	5,143
Contracted services	1,792	2,360	4,152
State fees	552	0	552
Miscellaneous	1,411	0	1,411
Depreciation	33,522	33,899	67,421
Total operating expenses	<u>72,456</u>	<u>64,264</u>	<u>136,720</u>
Operating income	<u>4,677</u>	<u>22,243</u>	<u>26,920</u>
<u>Non-Operating Revenue (Expenses)</u>			
Property taxes	41,094	0	41,094
Interest on investments	5,534	785	6,319
Interest expense	(25,850)	(11,500)	(37,350)
Total non-operating revenue (expenses)	<u>20,778</u>	<u>(10,715)</u>	<u>10,063</u>
Change in net assets	25,455	11,528	36,983
Net assets - beginning of year, as restated (Note 2)	<u>805,380</u>	<u>393,942</u>	<u>1,199,322</u>
Net assets - end of year	<u>\$ 830,835</u>	<u>\$ 405,470</u>	<u>\$ 1,236,305</u>

The accompanying notes to the financial statements are an integral part of this statement.

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
For the Year Ended December 31, 2004

	Business-Type Activities Enterprise Funds		
	Water Fund	Sewer Fund	Total
<u>Cash Flows from Operating Activities</u>			
Cash received from customers	\$ 77,792	\$ 86,683	\$ 164,475
Cash paid to suppliers and employees	(38,934)	(30,365)	(69,299)
Interest received	786	361	1,147
Refunds	80	65	145
Net cash provided by operating activities (Note 8)	<u>39,724</u>	<u>56,744</u>	<u>96,468</u>
<u>Cash Flows From Noncapital Financing Activities</u>			
Property taxes received	50,289	0	50,289
Cash paid to other funds	(1,083)	(3,917)	(5,000)
Net cash provided (used) by noncapital financing activities	<u>49,206</u>	<u>(3,917)</u>	<u>45,289</u>
<u>Cash Flows From Capital and Related Financing Activities</u>			
Principal paid on contract payable	0	(17,000)	(17,000)
Principal paid on bond payable	(10,000)	0	(10,000)
Interest paid on contract and bond payable	(25,850)	(11,500)	(37,350)
Net cash used by capital and related financing activities	<u>(35,850)</u>	<u>(28,500)</u>	<u>(64,350)</u>
<u>Cash Flows From Investing Activities</u>			
Proceeds from matured investments	104,470	0	104,470
Purchase of investments	(107,239)	0	(107,239)
Interest on investments	2,769	424	3,193
Net cash provided by investing activities	<u>0</u>	<u>424</u>	<u>424</u>
Net increase in cash and cash equivalents (Note 1)	53,080	24,751	77,831
Cash and cash equivalents at beginning of year (Note 1)	<u>160,923</u>	<u>56,929</u>	<u>217,852</u>
Cash and cash equivalents at end of year (Note 1)	<u>\$ 214,003</u>	<u>\$ 81,680</u>	<u>\$ 295,683</u>

The accompanying notes to the financial statements are an integral part of this statement.

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the City of Harrisville Water and Sewer Funds conform to accounting principles generally accepted in the United States of America (GAAP) applicable to governmental units. The following is a summary of the significant accounting policies.

A. Description of City Operations and Fund Type

The City of Harrisville Water and Sewer Funds operate as enterprise funds and are governed by an elected council with a City Manager overseeing daily operations. The basic financial statements of the City of Harrisville Water and Sewer Funds have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Water and Sewer Funds apply all relevant Governmental Accounting Standards Board (GASB) and Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions, that apply to all proprietary fund type activities, issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case GASB prevails. All activities over which the Water and Sewer Funds exercise oversight responsibility have been included in the reporting entity.

Oversight responsibility is determined by factors such as financial interdependency, selection of governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters of the entity.

B. Fund Accounting

The Water and Sewer Funds use funds to maintain their financial records during the year. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts.

Proprietary Fund

Proprietary fund reporting focuses on the determination of operating income, changes in net assets, financial position, and cash flows.

The City of Harrisville's Enterprise Funds report operations that provide services which are financed primarily by user charges, or activities where periodic measurement of net income is appropriate for capital maintenance, public policy, management control or other purposes.

C. Basis of Presentation

The Water and Sewer Funds' basic financial statements consist of fund financial statements which provide a detailed level of financial information.

Fund Financial Statements

During the year, the City segregates transactions related to certain Water and Sewer functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Fund financial statements are designed to present financial information of the City at a detailed level.

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Measurement Focus and Basis of Accounting

The term measurement focus is used to denote what is being measured and reported in the Water and Sewer Funds' operating statements. The Water and Sewer Funds are accounted for on the flow of economic resources measurement focus. The fundamental objective of this focus is to measure whether the Water and Sewer Funds are better or worse off economically as a result of events and transactions of the period.

The term basis of accounting is used to determine when a transaction or event is recognized on the Water and Sewer Funds' operating statements. The Water and Sewer Funds use the full accrual basis of accounting. Under this basis, revenues are recorded when earned and expenses are recorded when incurred, even though actual payment or receipt may not occur until after the period ends.

E. Cash and Cash Equivalents

For presentation on the financial statements, investments in cash management pools and investments with an original maturity of three months or less at the time they are purchased by the Water and Sewer Funds are considered to be cash equivalents. Investments with an initial maturity of more than three months are reported as investments.

F. Receivables

Receivables at December 31, 2004, consist of accounts (fees). All receivables are net of estimated uncollectible accounts. Receivables are recognized to the extent the amounts are determined material and substantiated, not only by supporting documentation but also by a reasonable systematic method of determining their existence, completeness, valuation, and collectibility.

The balances consist primarily of charges for water and sewer services due from various customers.

G. Capital Assets

Capital assets are stated at cost. Provision for depreciation is provided with respect to plant and equipment of the Water and Sewer Funds. Depreciation is calculated using the straight line basis at rates ranging from 2% to 20% per year. The estimated useful lives are as follows:

Buildings and plant	30 - 50 years
Equipment	5 - 10 years

Expenditures for maintenance, repairs and renewals are charged to operations as incurred and betterments are capitalized. The Water and Sewer Funds eliminate the cost and related allowances from the accounts for assets sold or retired and resulting gains or losses therefrom are included in operations concurrently. Donated fixed assets are recorded at their fair market values as of the date received.

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

I. Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the Water and Sewer Funds or through external restrictions imposed by creditors, grantors or laws or regulations of other governments. The Water and Sewer Funds' policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

J. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activities of the enterprise funds. For the Water and Sewer Funds, these revenues are charges for services for water and sewer services. Operating expenses are the necessary costs incurred to provide the service that is the primary activity of the funds. Revenues and expenses not meeting these definitions are reported as nonoperating.

K. Extraordinary and Special Items

Extraordinary items are transactions or events that are both unusual in nature and infrequent in occurrence. Special items are transactions or events that are within the control of the Council and that are either unusual in nature or infrequent in occurrence. Neither type of transaction occurred during the current year.

NOTE 2 - CHANGE IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF NET ASSETS

A. Change in Accounting Principles

For 2004, the Water and Sewer Funds have implemented Governmental Accounting Standards Board (GASB) Statement Number 33 "Accounting and Financial Reporting for Non-Exchange Transactions," as amended by Statement Number 36 "Recipient Reporting for Certain Shared Non-Exchange Revenue," which establishes standards for recording non-exchange transactions on the modified accrual and accrual basis of accounting; GASB Statement No. 34, "Basic Financial Statements -and Management's Discussion and Analysis -for State and Local Governments"; GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus"; and GASB Statement No. 38, "Certain Financial Statement Note Disclosures".

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004

NOTE 2 - CHANGE IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF NET ASSETS (CONTINUED)

A. Change in Accounting Principles (Continued)

GASB Statement No. 34 established new financial reporting standards for state and local governments. This statement requires a significant change in the financial reporting standards for state and local governments including the Management Discussion and Analysis Section, which provides an overall analysis of the financial position and results of operations and conditions that could have a significant effect on the financial position or results of operations.

GASB Statement No. 37 makes certain clarifications regarding escheat property and modifies several provisions of GASB Statement No. 34, including the Management's Discussion and Analysis. GASB Statement No. 38 modifies, establishes, and rescinds certain financial statement disclosure requirements.

B. Restatement of Net Assets

The restatement due to the implementation of the above statements and interpretation had the following effects on the net assets of the Water and Sewer Funds as they were previously reported.

	<u>Water Fund</u>	<u>Sewer Fund</u>
Retained Earnings December 31, 2003	\$ 340,746	\$ 138,303
Restatement of contributed capital in accordance with GASB Statement No. 33	<u>464,634</u>	<u>255,639</u>
Net Assets as restated at December 31, 2003	<u>\$ 805,380</u>	<u>\$ 393,942</u>

NOTE 3 - DEPOSITS AND INVESTMENTS

At year-end, the City of Harrisville Water and Sewer Funds' deposits and investments were reported in the basic financial statements in the following categories:

Cash and Cash Equivalents	\$ 295,683
Investments	<u>189,076</u>
	<u>\$ 484,759</u>

The breakdown between deposits and investments is as follows:

Bank Deposits (checking and savings accounts, certificates of deposit)	\$ 213,398
Investment in Municipal Investment Account Pooled Funds	<u>271,361</u>
Total	<u>\$ 484,759</u>

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004

NOTE 3 - DEPOSITS AND INVESTMENTS (CONTINUED)

Deposits:

Deposits are carried at cost. Deposits of the Water and Sewer Funds are held at various financial institutions in the name of the City. At year end, the carrying amounts of the Water and Sewer Funds' deposits were classified as to risk as follows:

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Insured (FDIC)	\$ 205,471	\$ 205,471
Uninsured – uncollateralized	<u>7,927</u>	<u>7,927</u>
	<u>\$ 213,398</u>	<u>\$ 213,398</u>

Investments:

The City Council has adopted an investment policy in accordance with Act 196, PA 1997 which authorizes the Water and Sewer Funds to deposit and invest in the following:

- * Accounts of federally insured banks, credit unions and savings and loan associations
- * Bonds and other direct obligations of the United States or an agency or instrumentality of the United States
- * United States government or federal agency obligation repurchase agreements
- * Banker's acceptances of United States banks
- * Commercial paper rated within the two highest classifications by not less than two standard rating services which mature not more than 270 days after the date of purchase
- * Mutual funds registered under the Investment Company Act of 1940, Title I of Chapter 686, 54 Stat. 789 15 U.S.C. 80a-1 to 80a-3 and 80a-4 to 80a-64 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation

Michigan law requires that public funds may not be deposited in financial institutions that do not maintain an office in Michigan. The Water and Sewer Funds' deposits and investments are in accordance with statutory authority.

The Water and Sewer Funds' investments are categorized to give an indication of the level of risk assumed by the City at December 31, 2004. The categories are described as follows:

Category 1 - Insured or registered, with securities held by the entity or its agent in the entity's name.

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name.

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the entity's name.

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004NOTE 3 - DEPOSITS AND INVESTMENTS (CONTINUED)

Investments: (Continued)

All investments at December 31, 2004 consisted of the following which are not required to be categorized:

	<u>Carrying Amount</u>	<u>Market Value</u>
<u>Nonrisk – Categorized</u>		
Huron Community Bank Municipal Investment Account	<u>\$ 271,361</u>	<u>\$ 271,361</u>

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended December 31, 2004, was as follows:

	<u>Balance January 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance December 31, 2004</u>
Capital Assets Not Being Depreciated:				
Land	<u>\$ 18,000</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 18,000</u>
Capital Assets Being Depreciated:				
Distribution and Collection Systems	2,716,812	0	0	2,716,812
Machinery and equipment	<u>59,161</u>	<u>0</u>	<u>0</u>	<u>59,161</u>
	<u>2,775,973</u>	<u>0</u>	<u>0</u>	<u>2,775,973</u>
Less accumulated depreciation	<u>1,274,955</u>	<u>67,421</u>	<u>0</u>	<u>1,342,376</u>
Net capital assets	<u>\$ 1,519,018</u>	<u>\$ 67,421</u>	<u>\$ 0</u>	<u>\$ 1,451,597</u>

NOTE 5 - LONG TERM LIABILITIES\$615,000 General Obligation Water Supply System Bond Dated September 14, 1989

Said bonds are issued pursuant to the resolutions adopted by the City Council of the City of Harrisville for the purpose of the construction of a water supply system and improvements.

These bonds constitute a valid and legally binding obligation of the City of Harrisville, payable from ad valorem taxes assessed in the City, and payable from net revenues of said water supply system collected from the users of such system through use charges pursuant to the ordinances of the City of Harrisville.

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004NOTE 5 - LONG TERM LIABILITIES (CONTINUED)\$615,000 General Obligation Water Supply System Bond Dated September 14, 1989 (Continued)

The bonds, which bear interest at 5%, are due serially through 2029, payable on July 1, with interest due semi-annually on January 1 and July 1 of each year.

Annual Principal and Interest Requirements

<u>Fiscal Year</u>	<u>January 1 Interest</u>	<u>July 1 Principal</u>	<u>July 1 Interest</u>	<u>Total Future Annual Requirements</u>
2005	\$ 0	\$ 11,000	\$ 12,800	\$ 23,800
2006	12,525	11,000	12,525	36,050
2007	12,250	12,000	12,250	36,500
2008	11,950	12,000	11,950	35,900
2009	11,650	13,000	11,650	36,300
2010	11,325	14,000	11,325	36,650
2011	10,975	14,000	10,975	35,950
2012	10,625	15,000	10,625	36,250
2013	10,250	16,000	10,250	36,500
2014	9,850	17,000	9,850	36,700
2015	9,425	17,000	9,425	35,850
2016	9,000	18,000	9,000	36,000
2017	8,550	19,000	8,550	36,100
2018	8,075	20,000	8,075	36,150
2019	7,575	21,000	7,575	36,150
2020	7,050	22,000	7,050	36,100
2021	6,500	23,000	6,500	36,000
2022	5,925	25,000	5,925	36,850
2023	5,300	26,000	5,300	36,600
2024	4,650	27,000	4,650	36,300
2025	3,975	29,000	3,975	36,950
2026	3,250	30,000	3,250	36,500
2027	2,500	32,000	2,500	37,000
2028	1,700	33,000	1,700	36,400
2029	875	35,000	875	36,750
	<u>\$ 185,750</u>	<u>\$ 512,000</u>	<u>\$ 198,550</u>	<u>\$ 896,300</u>

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004NOTE 5 - LONG TERM LIABILITIES (CONTINUED)\$462,000 Contract Payable - County, Dated March 5, 1976

The City of Harrisville entered into a contract with the County of Alcona, through its Board of Public Works, to finance a portion of the costs for sewage collection and treatment facilities. The City also enacted Ordinance No. 75-1 authorizing the sale of revenue bonds by the County.

Pursuant to Act no. 185, Public Acts of Michigan, 1957, the City has irrevocably pledged its full faith and credit for the payment of this issue. If revenues are insufficient to cover annual obligations, the City shall levy an ad valorem tax to pay these obligations.

Ordinance No. 75-1 requires the establishment of certain funds and accounts. A Receiving Fund is to be used for all incoming revenue. This account has been established. A Bond Reserve Account is to be opened whereby at least \$250 per quarter is to be deposited until there is accumulated the sum of \$30,000. All bonds carry interest at 5%. This requirement has been met.

Annual Principal and Interest Requirements

<u>Year</u>	<u>June 30 Interest</u>	<u>December 31 Principal</u>	<u>December 31 Interest</u>	<u>Total Future Annual Requirements</u>
2005	\$ 5,325	\$ 18,000	\$ 5,325	\$ 28,650
2006	4,875	19,000	4,875	28,750
2007	4,400	20,000	4,400	28,800
2008	3,900	21,000	3,900	28,800
2009	3,375	22,000	3,375	28,750
2010	2,825	22,000	2,825	27,650
2011	2,275	22,000	2,275	26,550
2012	1,725	22,000	1,725	25,450
2013	1,175	22,000	1,175	24,350
2014	<u>625</u>	<u>25,000</u>	<u>625</u>	<u>26,250</u>
	<u>\$ 30,500</u>	<u>\$ 213,000</u>	<u>\$ 30,500</u>	<u>\$ 274,000</u>

Changes in Long-Term Liabilities

	<u>Balance January 1, 2004</u>	<u>Issues or Additions</u>	<u>Payments or Expenditures</u>	<u>Balance December 31, 2004</u>	<u>Due Within One Year</u>
Bond payable	\$ 522,000	\$ 0	\$ 10,000	\$ 512,000	\$ 11,000
Contract payable	<u>230,000</u>	<u>0</u>	<u>17,000</u>	<u>213,000</u>	<u>18,000</u>
Total	<u>\$ 752,000</u>	<u>\$ 0</u>	<u>\$ 27,000</u>	<u>\$ 725,000</u>	<u>\$ 29,000</u>

CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2004

NOTE 6 - SEGMENT INFORMATION

For the year ended December 31, 2004, segment information is as follows:

	<u>Water Fund</u>	<u>Sewer Fund</u>	<u>Total Enterprise Funds</u>
Operating revenue	\$ 77,133	\$ 86,507	\$ 163,640
Depreciation expense	\$ 33,522	\$ 33,899	\$ 67,421
Operating income	\$ 4,677	\$ 22,243	\$ 26,920
Change in net assets	\$ 25,455	\$ 11,528	\$ 36,983
Net working capital	\$ 371,130	\$ 109,578	\$ 480,708
Total net assets	\$ 830,835	\$ 405,470	\$ 1,236,305

NOTE 7 - UNEMPLOYMENT COMPENSATION

The City is subject to the Michigan Employment Security Act and has elected the reimbursement method of financing. Under this method, the City must reimburse the Employment Agency for all benefits charged against the City. No liabilities were due as of December 31, 2004.

NOTE 8 - RISK MANAGEMENT

The Water and Sewer Funds are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and natural disasters. The Water and Sewer Funds continue to carry commercial insurance for risks of loss. Settled claims for the commercial insurance have not exceeded the amount of insurance coverage in any of the past three years.

NOTE 9 - RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	<u>Water Fund</u>	<u>Sewer Fund</u>	<u>Total Enterprise Fund</u>
Operating income	\$ 4,677	\$ 22,243	\$ 26,920
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	33,522	33,899	67,421
Interest income on cash and cash equivalents	786	361	1,147
Changes in assets and liabilities:			
Decrease in accounts receivable	<u>739</u>	<u>241</u>	<u>980</u>
Net cash provided by operating activities	<u>\$ 39,724</u>	<u>\$ 56,744</u>	<u>\$ 96,468</u>

OTHER INFORMATION

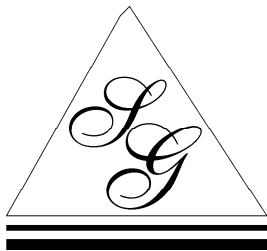
CITY OF HARRISVILLE
WATER AND SEWER FUNDS
Alcona County, Michigan

SUPPLEMENTAL INFORMATION FOR FARMERS HOME ADMINISTRATION
For the Year Ended December 31, 2004

1. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America.
2. An evaluation of the internal control structure is included in the financial statements.
3. The accounting records maintained by the City of Harrisville for the Water and Sewer Funds are satisfactory and we have no recommendations for improvement.
4. The City's physical control of the assets is satisfactory.
5. The City is in financial compliance with the loan agreement. Certain reporting requirements will be met with the issuance of this report.
6. The financial reports included in this audit report are in agreement with the accounting records of the City and no major or unusual adjustments are necessary.
7. Deposit funds of the project are in financial institutions insured by the federal government.
8. The City of Harrisville has insurance coverage on all of its equipment at replacement cost.
9. The City of Harrisville is exempt from federal income tax.
10. No unsatisfactory conditions were noted during the audit.
11. An aging of accounts receivable as of December 31, 2004 is as follows:

	<u>Total</u>	<u>0 – 30</u>	<u>31 – 60</u>	<u>61 – 90</u>	<u>Over 90</u>
Customers:					
Water Fund	\$ 17,163	\$ 16,820	\$ 0	\$ 0	\$ 343
Sewer Fund	\$ 20,981	\$ 20,544	\$ 0	\$ 0	\$ 437

12. No other information is necessary for full disclosure.



Stephenson Gracik & Co., P.C.

Certified Public Accountants & Consultants

Alan J Stephenson, CPA
Gerald D Gracik Jr., CPA
James J Gracik, CPA
E. Thad Gray, CPA
Donald W. Brannan, CPA
Kyle E Troyer, CPA

Herman A Bertuleit, CPA

February 4, 2005

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Members of the City Council
City of Harrisville
Alcona County, Michigan

We have audited the financial statements of the business-type activities of the City of Harrisville Water and Sewer Funds, as of and for the year ended December 31, 2004, which collectively comprise the City of Harrisville Water and Sewer Funds' basic financial statements, and have issued our report thereon dated February 4, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the City of Harrisville Water and Sewer Funds' financial statements are free of material misstatement, we performed tests of their compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Harrisville Water and Sewer Funds' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted one matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City of Harrisville Water and Sewer Funds' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described below:

Separation of Duties in the Performance of Functions

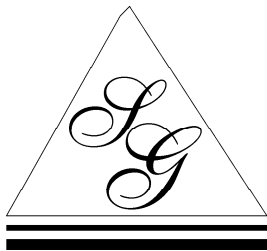
Due to the limited number of staff of the City, there is an absence of appropriate segregation of duties. The clerk receives cash, has control over non-cash accounting records and writes and signs checks. To offset this deficiency, bank reconciliations and a dual signature are required of the City Treasurer.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above to be a material weakness.

Members of the City Council
City of Harrisville
February 4, 2005
Page Two

This report is intended solely for the information and use of management, City Council and the Michigan Department of Treasury and is not intended to be and should not be used by anyone other than these specified parties.

Stephenson, Graish & Co., P.C.



Stephenson Gracik & Co., P.C.

Certified Public Accountants & Consultants

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February 4, 2005

Members of the City Council
City of Harrisville
Alcona County, Michigan

Dear Council Members:

We have audited the financial statements of the City of Harrisville Water and Sewer Funds for the year ended December 31, 2004, and have issued our report thereon dated February 4, 2005. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards and Government Auditing Standards

As stated in our engagement letter dated December 23, 2004, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the basic financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the City of Harrisville Water and Sewer Funds' internal control over financial reporting in order to determine our audit procedures for the purpose of expressing our opinion on the financial statements and not to provide any assurance on the internal control over financial reporting.

As part of obtaining reasonable assurance about whether the City of Harrisville Water and Sewer Funds' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City of Harrisville Water and Sewer Funds are described in Note 1 to the financial statements. As described in Note 2 to the financial statements, the City of Harrisville Water and Sewer Funds changed accounting policies as a result of adopting Statement of Governmental Accounting Standards (GASB Statements) No. 33, 34, 36, 37 and 38, in the year ended December 31, 2004. We noted no transactions entered into by the City of Harrisville during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the City of Harrisville Water and Sewer Funds' financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment,

Members of the City Council
City of Harrisville
February 4, 2005
Page Two

none of the adjustments we proposed, whether recorded or unrecorded by the City of Harrisville Water and Sewer Funds, either individually or in the aggregate, indicate matters that could have a significant effect on the City of Harrisville Water and Sewer Funds' financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City of Harrisville Water and Sewer Funds' auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

Additional Information

As a result of our study and evaluation of the internal controls as described in the third paragraph, one matter came to our attention upon which we would like to comment.

Separation of Duties in the Performance of Functions

Due to the limited number of staff of the City, there is an absence of appropriate segregation of duties. The clerk receives cash, has control over non-cash accounting records and writes and signs checks. To offset this deficiency, bank reconciliations and a dual signature are required of the City Treasurer.

We wish to express our appreciation for the cooperation and courtesies extended our staff by management and employees of the City.

This information is intended solely for the use of management and City Council and is not intended to be and should not be used by anyone other than these specified parties.

Stephenson, Grainh & Co., P.C.